

## The Importance of Cash Forecasting

By Dennis Gniewosz  
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Debbie: Hello, and thank you for joining us today. You're listening to a J.P.Morgan podcast discussing the importance of cash forecasting. My name is Debbie Hartley, and I'll be serving as moderator. I'm joined today by Dennis Gniewosz, vice president and senior consultant, J.P.Morgan Treasury Services Consulting. Welcome, Dennis.

Dennis: Thank you, Debbie.

Debbie: Getting started, why is cash forecasting so important?

Dennis: I think the recent crisis has really pointed this out for our clients and actually even emphasized what was already an important point. The best way an organization can operate is to self-fund, is to make the best use of the cash that they have on hand. And the best way to really do this is to forecast accurately, and in effect use the benefit of that forecast in your cash decisioning.

Debbie: And what are some best practices for establishing a disciplined approach to cash forecasting?

Dennis: I think the number one concern that most clients have when they ask that kind of question is how do I create the structure? Well, the first part of it, I would say before you even get structure is you need sponsorship at the senior management level. And that's because if you really want a good forecast, you have to get as much accurate information as possible, and this accurate information is only obtainable if you get partnership of other peers in your organization, and if in fact you have really good access.

So the example there is for someone in treasury, and treasury is a natural spot for forecasting to be centered, in order for someone in treasury to come up with a good forecast, they really have to work closely with the accounts payable staff. Now, that doesn't mean that they give the accounts payable staff extra work to do, or they take accounts payable reports, because then in that case, the firm has duplicated its efforts, and it's not really helpful. There is some level of cooperation between the two groups that allows the treasury to in effect get better accounts payable information, and put that in their forecast. Really, the most important part of the forecast, any kind of forecasting, is that it's reliable and predictable. I emphasize the predictable part, because if you're really not going to get a future view out of your forecasting, then really it really doesn't make sense to forecast. So there's a physical cost associated with forecasting. There's a significant effort in your organization. There's a need for discipline. There's a need for reaching out and cooperating with other parts of the organization, and to do these all takes a significant effort, but the effort really does come back in payback. And the emphasis that we see in larger corporations and the top leaders in the field, the best practices, is that they really are doing a lot in their forecast to be accurate. Now, that said, I could also tell you that anecdotally, a lot of very fine well run corporations have a difficult time getting a forecast that is within even 10 to 15 percent accuracy. So to give you a sense of how difficult it is to really do a good forecast.

Debbie: Okay, thank you. Who should be accountable for cash forecasting, especially if you are a global company? And then how often should you forecast? Is once a week enough?

Dennis: That's a great question too. I think if you really look at this, and you're really making the best effort to use the funds that the company has, you're really talking, from a global perspective, it has to be at a headquarters level, or at a regional level, such that it can take advantage basically of the layers of the company. So you want to have it at that

level. It certainly would not be unreasonable to have multiple forecasts and have those cascading upward, but you really want to get at the end of the day a level of awareness in your firm where this information could be used.

So for example, you could have a regional forecast in Asia, and have this tier up for multiple countries into the region, or even better, and this is where the global perspective comes in, you could have global perspective taking it either directly from the regions or separately. So you really need to get up to an actionable level, and strategically the higher up and the more that you can use the forecast, the better your firm will be, because you will actually get the best use of funds. That said, forecasting should be a daily process, and forecasting should be an active dynamic process. So it should never be something where you once a month or once a week or once a quarter post up a position. It should be that you are constantly managing your position, and that you are getting new and contemporaneous inputs from different people. Otherwise, your forecast will grow stale very quickly, and you have a very, very unlikely possibility of coming out with a really good predictive forecast.

Debbie: And what are some of the benefits of effective cash forecasting?

Dennis: The primary benefit of effective cash forecasting is an improvement in your working capital, because if you go out to your banks, you go out to your lenders, you're going to pay for funds, and a lot of times there are funds inside your organization, and it's just a question really of not only recognizing when those funds are available to be mobilized, but also of keeping a certain stability and predictability, so you can know the best time to use those funds.

An example I would give is if you have a company that's a travel company, they happen to know what the travel trends are, and this greatly affects their forecast. So in their case, seasonality is an incredibly important factor. It's something that will definitely play in their forecast.

Another example that I would give you is the phone company. You might not know this, but in the United States, the Mother's Day holiday is the second heaviest telephone-calling holiday. And believe it or not, the phone company has to put this into consideration, because while you might be using say a long distance carrier, or you might be using your wireless phone, in the end, say you are using your wireless phone, say in a place like New York, and you're calling your mother in California, when that call terminates in California, that wireless provider is going to have to pay the company that owns the California telephone line. Well, these kinds of things have to be forecast. Again, it's a matter of increasing your use of these funds so that when you may in fact have idle cash, or when your cash is not being mobilized as much as possible, you can mobilize it. And at other times when you know you are going to come for a need of cash, this is when the cash forecast view can save you from being surprised, or from having to go out in the market and borrow.

Debbie: How can a company improve their current forecasting process? Can you provide any kind of advice about cash forecasting in this current economic environment?

Dennis: I think that for a company to improve their current forecast, we see this in the market today, but more companies are taking this more seriously, and they are making it more of a professional discipline. That's part of the key. This idea that it's an added function that the treasury would happen to do, and perhaps it's almost like putting numbers on the back of a napkin, that kind of thing, to get a sense of where we are if the treasurer or the CFO needs to have a figure. Getting rid of that notion, and getting more to the idea that we want to really be on top of things, and you really want to take advantage of things, those are really the best things that you can do to improve the cash forecasting. And what that will do is create greater accuracy. So let's talk about just two good examples of that.

The first example, and I go back to the idea of using something like accounts payable, the idea of getting an automated feed, or the idea of creating an agreement with the accounts payable department ahead of time that certain information will deliver, will create a more accurate forecast. It's a matter of institutionalizing it. It's a matter that people all believe in the same mission. It's the idea that there are simple things that we can do that basically institutionalize it and make it much more disciplined, much more standardized.

Another example is, believe it or not, people don't use the same statistics. People don't use the same approaches. We need to — a client needs to look at the forecast in hand and determine how accurate would they like to be. Do they want to be accurate down to the nearest dollar, or are they talking about somewhere within factors of 1,000 or factors of 1 million? It's very important, because the more accurate that they wish to be, the more they have to focus on the discipline of making sure that the numbers are not that far off. If we take five different people, and each person is off by five percent, we magnify how the forecast fails. So what we have to do is get this discipline in and have basically the five people be closer, or at least give us some sense that their numbers are off by a certain percent. That's what you can do to improve the forecasting.

In our current environment, I think one of the things that would be great to do, would be to continue to take professional classes and to push the major industry bodies to keep on using these kind of forums to have classes and discuss. It would be great if companies shared a little more information on how they're forecasting so people can get a sense of how the mechanisms might play. You could also look at things like treasury management systems and various software vendors and that sort of thing. I caution with any of this kind of stuff, you always have to be buyer-beware, but you know, the tools are out there. Although that said, it's perfectly acceptable and highly likely that you could do a very good forecast with Excel spreadsheets if it's done properly, and if you actually take the time to discipline and get the input. So I would say in the current environment, it's really important to get it done and just keep on honing the skills so that the forecasts are better, and don't give up on it. It's also a lot more difficult these days than it used to be.

Debbie: Thanks for joining us today, Dennis. We appreciate your thoughts and insights on cash forecasting. This concludes our J.P.Morgan podcast presentation.

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